

MUTUAL FUNDS DEMYSTIFIED

Newsletter 02 | Decision Mistakes

The Fund That Dazzled You Last Year Is Probably Letting You Down Right Now.

And the worst part? You walked into this trap with both eyes open.

Every January, investors across India scroll through "Top Performing Mutual Funds" lists. They spot a fund that returned 57% or 45% the previous year, and their pulse quickens. What follows feels entirely logical: they invest. It is, in fact, one of the most natural decisions a human being can make — and one of the most financially destructive.

This is **the Past Returns Trap**. Unlike a market crash, it does not arrive as a shock. It arrives quietly — as a star rating, a glowing percentage, and an entirely convincing sense of certainty. By the time most investors recognise the trap, they are already well inside it.

SECTION 1: THE TRAP AND THE PROOF

The human brain is wired for pattern recognition, and recent trends feel like reliable signals. In investing, however, this instinct can be quietly devastating. Researchers call it recency bias: the tendency to assign disproportionate weight to recent events when forming expectations about the future. This behaviour produces what behavioural economists call the “dumb money” effect — a recurring pattern in which investor capital flows steadily into funds that have just peaked, and away from funds that are on the verge of recovery.

The evidence is not theoretical. It is embedded in actual fund performance data.

Motilal Oswal Flexi Cap Fund was **the #1 performer in its category in 2024, returning 45.7%**. Thousands of investors, drawn by that headline figure, put their money into the fund through early 2025. The fund’s return in 2025? **-3.07%**. Negative. Those who chased the 2024 headline not only missed the subsequent rally — they lost capital in a year when the broader market delivered positive returns.

Fund	2024 Return (1-Year Star)	2025 Return (Reality Check)
Motilal Oswal Flexi Cap	#1 Flexi Cap: +45.7%	-3.07% (negative return)
Motilal Oswal Midcap	#1 Mid Cap: +57.1%	+16.62% (vs 57.1% prior year)
Active Large Cap (category)	Many beat benchmark in 2024	93% underperformed over 5 years

This is not an isolated case. According to the SPIVA India Year-End 2024 Scorecard, **93% of active large-cap funds underperformed their benchmark over 5 years**, even though many of those same funds had posted strong one-year figures at some point. As a rule, the fund that tops the rankings in any given year is rarely the one that sustains that performance.

Finideas Insight: *The irony of the past returns trap: by the time a fund looks attractive enough to buy, the conditions that produced those returns have often already passed.*

¹ Value Research Online: Motilal Oswal Flexi Cap Fund Regular Plan, 1-Year Return as of Jul 2025: -3.07% | valueresearchonline.com

² Business Standard / Ventura Securities: Best and Worst Performing Mutual Funds of 2024 | business-standard.com, Jan 15 2025

³ SPIVA India Scorecard, Year-End 2024: S&P Dow Jones Indices | spglobal.com/spdji, Apr 2025

⁴ SEBI Investor Education: Common Investment Mistakes and Behavioural Biases | investor.sebi.gov.in

SECTION 2: WHY RETURNS CAN LIE

The Point-to-Point Problem

A CAGR of 18% over five years may sound impressive — until you ask what the distribution of those returns actually looks like. If the fund delivered 60% in year one and was largely flat thereafter, the headline figure tells a very incomplete story. Point-to-point returns are acutely sensitive to the start and end dates selected. Choose a different five-year window and the narrative can change entirely. Yet every standard fund comparison table uses point-to-point figures, and none discloses how the picture shifts from alternative starting points.

The Survivorship Bias Distortion

When you examine a “Top Funds of the Decade” list, you are reviewing a curated survivor pool. Funds that underperformed were frequently merged into other schemes or quietly wound down before they attracted wider scrutiny. The SPIVA India data corrects for this survivorship effect — and the long-term underperformance figures remain stark regardless.

The Category Rotation Effect

A fund that led its category rankings in 2021 may have done so simply because it was a small-cap fund during a small-cap rally. When that category corrected sharply in 2022, the fund’s ranking collapsed — not because the manager had lost skill, but because the tailwind had reversed. Investors who chased the 2021 return entered at the peak of a category cycle, mistaking a favourable market phase for evidence of managerial quality.

Finideas Insight: *Judging a fund by its 1-year return is like judging a cricketer by one innings. You need consistency across conditions, not brilliance on one good pitch.*

⁵ Value Research Online: Understanding Rolling Returns and Why Point-to-Point Misleads | valueresearchonline.com

⁶ SPIVA India Scorecard: Survivorship Rates Across Fund Categories, Year-End 2024 | spglobal.com/spdji

SECTION 3: WHAT TO LOOK AT INSTEAD

If one-year returns mislead and three-year CAGRs carry structural limitations, what does a disciplined investor actually rely on? The answer is a combination of metrics that reveal how a fund behaves across different market environments — not only during favourable ones.

Metric	The Problem	When to Use It
1-Year Return	Last year's winner is rarely next year's winner. This is the trap.	Curiosity only. Never as a selection criterion.
3Y / 5Y CAGR	Point-to-point: sensitive to start and end date chosen.	Shortlisting. Always compare against category benchmark.
Rolling Returns	No trap. Most honest picture of consistency available.	Primary tool for fund evaluation across market cycles.

Sharpe Ratio	Ignored by investors chasing headline return numbers.	Measures return earned per unit of risk. Higher is better.
Downside Capture	Rarely disclosed proactively by distributors.	Reveals how much the fund falls when the market falls.

Rolling returns represent the most transparent starting point: calculated across hundreds of overlapping time windows, they eliminate the distortion created by any single start date. The Sharpe Ratio quantifies how much return was earned per unit of risk taken. And the downside capture ratio answers the question most investors never think to ask: **how much of the market's fall does this fund absorb?** A fund with a downside capture ratio of 60% loses only 60% of what the market loses in a downturn. That capacity for capital preservation is frequently where long-term wealth is made — or forfeited.

Finideas Insight: *A fund that falls 40% needs to rise 67% just to break even. Protecting the downside is not conservatism. It is mathematics.*

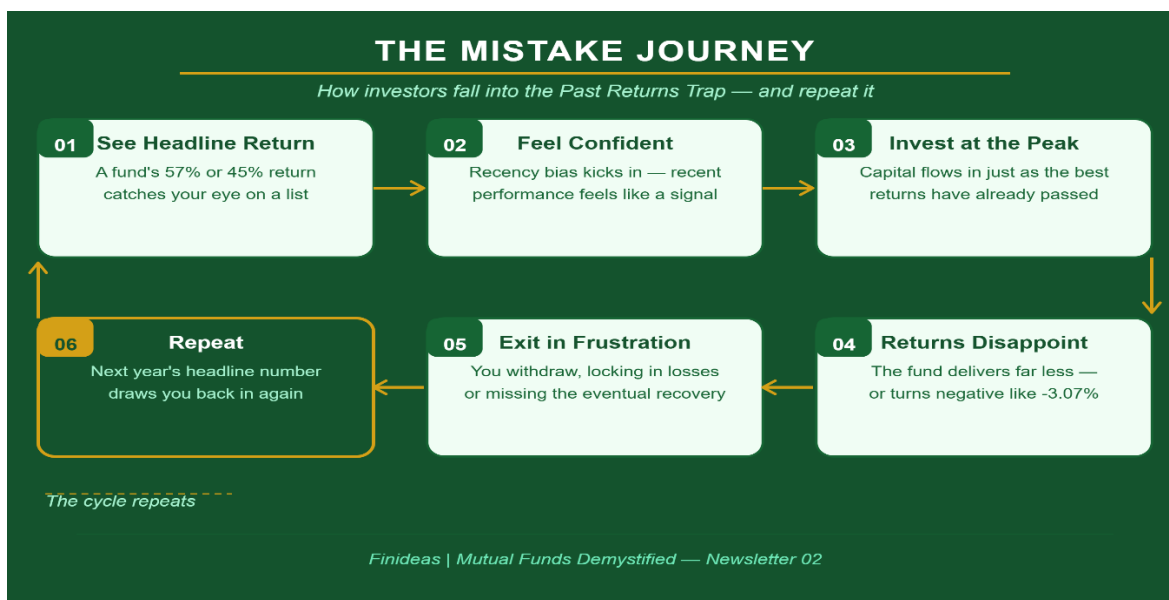
⁷ SEBI Investor Education: Understanding Sharpe Ratio and Risk-Adjusted Performance | investor.sebi.gov.in

⁸ Morningstar India: Rolling Return Methodology and Consistency Analysis | morningstar.in

⁹ PPFAS Mutual Fund Fact Sheet: Historical Downside Capture Ratio | ppfas.com

VISUAL SUMMARY: The Mistake Journey

How investors fall into the Past Returns Trap — and repeat it.



SECTION 4: FOUR QUESTIONS BEFORE YOU INVEST

The next time you find yourself drawn to a fund on the strength of a striking one-year return, pause and apply these four questions. If the fund cannot satisfy more than two of them, past performance is carrying the entire investment case — and past performance, as the data consistently shows, is not a reliable predictor of future results.

Is this fund on my radar only because of a 1-year number? If the answer is yes, that is a warning sign — not an investment rationale. Motilal Oswal Flexi Cap's 45.7% return in 2024 became -3.07% in 2025. Those who chased that headline figure discovered the outcome firsthand.

Does it rank in the top half of its category on 3Y and 5Y rolling returns? Funds that deliver consistent performance across multiple time windows are significantly more valuable than one-year standouts. A single exceptional year does not constitute a reliable investment case.

How did it perform during the 2020 COVID crash and the 2022 rate-hike correction?

How a fund behaves in adverse conditions reveals its true character. A fund that holds its ground when markets decline is protecting the foundation upon which your long-term compounding rests.

Is the investment in the direct plan? Even a fund with a strong track record in its regular plan silently underperforms its own direct plan equivalent — every single day — through the embedded distributor commission that is built into the expense ratio.

Thousands of crores in Indian household savings underperform each year — not because markets have been unkind, but because investment decisions were anchored to a single number on a brochure. The best funds, at the point of entry, rarely look exciting. They are consistent, less volatile, and unlikely to top any annual ranking. Five years on, however, they are the ones steadily compounding wealth — while investors who chased headlines have already cycled through their third or fourth fund.

Finideas Insight: *At Finideas, our first question when reviewing a fund is never 'what did it return last year?' It is 'how did it behave when markets fell, and has it been consistent over a full market cycle?'*

A 40% fall doesn't just hurt — it demands a 67% gain just to get back to zero. Most investors never do that maths. In Newsletter 03, we go deep on drawdowns: what they really cost, how long recoveries actually take, and why the funds that fall the least are often the ones that build the most wealth. Protecting the downside isn't caution. It's strategy.

¹⁰ Policybazaar: Motilal Oswal Flexi Cap Fund Regular Growth, 1-Year Return -3.07% as of Jul 2025 | policybazaar.com

¹¹ SEBI: Mutual Fund Performance Disclosure Guidelines and Investor Rights | sebi.gov.in

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REFERENCE

SEBI Circular No.: SEBI/HO/MIRSD/MIRSD-PoD-2/P/CIR/2023/52 dated April 6, 2023.